

## DEPARTMENT OF STATE REVENUE

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04-20200100R.ODR  
04-20200102R.ODR  
04-20200103R.ODR  
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**Final Order Denying Refund: 04-20200099R; 04-20200100R;  
04-20200102R; 04-20200103R; 04-20200104R  
Gross Retail Tax  
For the Years 2015 through 2019**

**NOTICE:** IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

### HOLDING

Indiana Research Facilities failed to establish that the Department should reconsider Research Facilities' sales tax refund claims on the ground that Research Facilities' utilities were entirely exempt; in doing so, the Department pointed out that there was no 100 percent "predominant use" research and development exemption provision.

### ISSUE

#### I. Gross Retail Tax - Research and Development Exemption.

**Authority:** IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-40 (effective until January 1, 2016); IC § 6-2.5-5-40 (effective until June 30, 2013); IC § 6-2.5-5-40(b); IC § 6-2.5-5-40(d); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-4-13\(e\)](#); [45 IAC 2.2-5-10\(a\)](#); Sales Tax Information Bulletin 55 (May 2012); Information Bulletin 55 (August 2011); Sales Tax Information Bulletin 75 (October 2008); Sales Tax Information Bulletin 75 (July 1, 2013); Sales Tax Information Bulletin 75 (April 2017); Federation of Tax Administrators, <https://www.taxadmin.org/assets/docs/Publications/sutca.pdf>.

Taxpayers argue that they are entitled to a refund of sales tax paid on the purchase of utilities because their electric, water, and natural gas utilities - totaled together - are predominantly consumed in the performance of qualifying research and development activities.

### STATEMENT OF FACTS

Taxpayers are five related Indiana pharmaceutical research facilities (for simplicity's sake hereinafter "Taxpayer") each of which filed separate refund claims (GA-110L) seeking a total refund of approximately \$1,600,000 in sales tax primarily paid on the purchase of utilities.

For four of the facilities, Taxpayer paid the tax on the purchase of utility services consumed during 2015 through 2018. According to Taxpayer's original claim the purchases were exempt because it "uses this electricity [gas and water] in their research [and] development functions."

In the case of one of the five facilities, Taxpayer sought a refund of sales tax paid during 2019.

The Indiana Department of Revenue ("Department") reviewed the refund claims. The Department's representative did not visit or tour Taxpayer's facilities because "[T]axpayer did not add any equipment to any of the previous utility studies."

- For the first facility, Taxpayer requested a refund of all sales tax paid on the purchase of electric, natural gas, and water utilities. The Department found that Taxpayer was entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption

on the purchase of water. The Department denied the remainder of the refund requests.

- For the second facility, Taxpayer requested a refund of all sales tax paid on the purchase of electric, natural gas, and water utilities. The Department found that Taxpayer was entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption on the purchase of water. The Department denied the remainder of the refund requests.
- Likewise, for the third facility, Taxpayer requested a refund of all sales tax paid on the purchase of electric, natural gas, and water utilities. The Department found that Taxpayer was entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption on the purchase of water. The Department denied the remainder of the refund requests.
- For the fourth facility, Taxpayer requested a refund of all sales tax paid on the purchase of electric and natural gas (not water) utilities. The Department found that Taxpayer was entitled to a 38 and 61 percent respective exemption on the purchase of electricity consumed at that particular facility's two buildings. In addition, the Department found that Taxpayer was entitled to a 67 percent exemption on the purchase of natural gas. The Department denied the remainder of the refund request.
- The fifth facility was subject to a previous "Sales and Use Tax Compliance Agreement" ("SUTCA"). Taxpayer sought a refund of 2019 sales and use tax. Taxpayer argued it had paid tax in excess of the amount called for in the SUTCA. The Department determined that Taxpayer was entitled to a portion of the refund sought but denied the remainder.

In the case of each of the five facilities, the Department concluded that Taxpayer was entitled to a partial refund totaling approximately \$942,000.

Taxpayer disagreed with the Department's decision denying approximately \$670,000 of the originally filed refund request and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representatives explained the basis for the protest. This Final Order Denying Refund results.

## **I. Gross Retail Tax - Research and Development Exemption.**

### **DISCUSSION**

The issue is whether Taxpayer has established that it is entitled to a refund of all sales tax paid on the purchase of water, natural gas, and electric utilities on the ground that these utilities were predominantly consumed in its Research and Development (R&D) activities.

#### **A. The Research and Development Exemption Statute and the Burden of Proof.**

##### **(1) Indiana's Sales and Use Tax.**

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

In general, purchases of tangible personal property are subject to sales tax. [45 IAC 2.2-5-10\(a\)](#). Tangible personal property means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. IC § 6-2.5-1-27. Tangible personal property also includes electricity, water, gas, steam, and prewritten computer software. *Id.*

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

##### **(2) Research and Development Sales Tax Exemption.**

In 2013, in addition to "research and development equipment," the Indiana General Assembly considered a sales tax exemption on the purchase of "research and development property." See P.L. 288-2013, sec. 29, codified as amended at IC § 6-2.5-5-40(c) and (e) (eff. July 1, 2013). IC § 6-2.5-5-40(g) (as in effect for tax years 2015 through 2019) IC § 6-2.5-5-40 (effective until January 1, 2016) provides a sales tax exemption for "research and development property" after June 30, 2013.

IC § 6-2.5-5-40(d) explains that a taxpayer is entitled to purchase certain items of tangible personal property without paying the gross retail tax when the property is utilized in qualifying R&D activities. In full, the exemption is set out in IC § 6-2.5-5-40 as follows.

- (a) As used in this section, "research and development activities" does not include any of the following:
  - (1) Efficiency surveys.
  - (2) Management studies.
  - (3) Consumer surveys.
  - (4) Economic surveys.
  - (5) Advertising or promotions.
  - (6) Research in connection with literary, historical, or similar projects.
  - (7) Testing for purposes of quality control.
- (b) As used in this section, "research and development *equipment*" means tangible personal property that:
  - (1) consists of or is a combination of:
    - (A) laboratory equipment;
    - (B) computers;
    - (C) computer software;
    - (D) telecommunications equipment; or
    - (E) testing equipment;
  - (2) has not previously been used in Indiana for any purpose; and
  - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
    - (A) new products;
    - (B) new uses of existing products; or
    - (C) improving or testing existing products.
- (c) As used in this section, "research and development property" means tangible personal property that:
  - (1) has not previously been used in Indiana for any purpose; and
  - (2) is acquired by the purchaser for the purpose of research and development activities devoted to experimental or laboratory research and development for:
    - (A) new products;
    - (B) new uses of existing products; or
    - (C) improving or testing existing products.
- (d) A retail transaction:
  - (1) involving research and development equipment; and
  - (2) occurring after June 30, 2007, and before July 1, 2013;is exempt from the state gross retail tax.
- (e) A retail transaction:
  - (1) involving research and development property; and
  - (2) occurring after June 30, 2013;is exempt from the state gross retail tax.
- (f) The exemption provided by subsection (e) applies regardless of whether the person that acquires the R&D property is a manufacturer or seller of the new or existing products specified in subsection (c)(2).
- (g) For purposes of this section, a retail transaction shall be considered as having occurred after June 30, 2013, to the extent that delivery of the property constituting selling at retail is made after that date to the purchaser or to the place of delivery designated by the purchaser. However, a transaction shall be considered as having occurred before July 1, 2013, to the extent that the agreement of the parties to the transaction is entered into before July 1, 2013, and payment for the property furnished in the transaction is made before July 1, 2013, notwithstanding the delivery of the property after June 30, 2013. This subsection expires January 1, 2017.

(Emphasis added).

The version of IC § 6-2.5-5-40 (effective to June 30, 2013) referred to exempt "equipment" which the Department determined "does not include . . . property with a useful life of less than one year." Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA. The "more than one year" requirement was deleted in IC § 6-2.5-5-40 (effective July 1, 2013 to December 31, 2015). As explained in Sales Tax Information Bulletin 75 (July 1, 2013), 20131127 Ind. Reg. 045130524NRA.

With regard to the new exemption available for research and development property purchased after June 30, 2013, there is no requirement that the property have a useful life of one year or more, nor are consumables or hand-powered tools excluded from the definition. (Emphasis added).

The common thread running through each iteration of IC § 6-2.5-5-40 is:

The exemptions for research and development equipment and research and development property apply only to equipment or property purchased for the purpose of research and development activities. Sales Tax Information Bulletin 75 (April 2017).

### **(3) Qualifying for the Research and Development Exemption.**

IC § 6-2.5-5-40 like all tax exemption provisions, is strictly construed against the taxpayer. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Indiana law has long held that "[W]here [] an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974) (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Nevertheless, the Department is also well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

## **B. The Department's Original Review of Taxpayer's Refund Claim.**

In considering Taxpayer's original request, the Department's representatives reviewed the GA-110L refund requests. The Department's report concluded that Taxpayer was entitled to a portion of the refunds originally requested on the ground that the "exempt percentages found are related to utilities consumed in research and development. The exempt percentages found are the percentages to be granted in a refund."

## **C. Taxpayer's Arguments.**

Taxpayer argues that it is entitled to a refund of all sales tax paid on the purchase of utilities because its utilities are predominantly consumed in conducting R&D purposes. As Taxpayer explains, "[W]e respectfully request one hundred (100) percent of the denied utilities under appeal used predominantly, directly in manufacturing and research and development activities . . . . The utilities serve as an essential and integral conduit to the development and production processes . . . ."

In arriving at its decision that it is entitled to a 100 percent refund of the sales tax paid on utilities, Taxpayer notes that the Department determined that four of its facilities were typically entitled to an exemption in excess of 50 percent. For example, the first three facilities were entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption on the purchase of water.

At the fourth facility, the Department found that Taxpayer was entitled to a somewhat lesser percentage. In that particular case, the Department found that the fourth facility was entitled to a 38 and 61 percent respective exemption on the purchase of electricity consumed at two buildings and a cumulative 67 percent exemption on the purchase of natural gas. Taxpayer now asserts that each of the percentages in excess of 50 exceed the "predominant use" standard and justify an additional refund of sales tax.

### **(1) Analysis of Taxpayers' "Predominantly Used" Argument.**

At the outset, the Department agrees with Taxpayer that utilities - statutorily categorized as "tangible personal property" - fit squarely within Indiana's R&D exemption found at IC § 6-2.5-5-40(b).

However, Taxpayer suggests that it is entitled to a refund of 100 percent of the tax because its *utilities* are "predominantly used" for R&D purposes. Utility transactions are exempt from sales and use tax when the sales "are (1) by public utilities or power subsidiaries; (2) used in manufacturing, production, etc.; and (3) either separately metered or predominantly used in an excluded manner." Sales Tax Information Bulletin 55 (May 2012), 20120530 Ind. Reg. 045120251NRA. See also Sales Tax Information Bulletin 55 (August 2011), 20110928 Ind. Reg. 045110518NRA.

Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. "Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses." [45 IAC 2.2-4-13\(e\)](#).

Generally, to qualify for predominant use, a purchaser of a utility must show that more than 50 percent of the utility is used "as an essential and integral part of an integrated part of an *integrated production process*." Sales Tax Information Bulletin 55 (May 2012) (*Emphasis added*).

In this case, Taxpayer errs in its interpretation and application of the "predominant use" standard because the predominant use provision applies to utilities consumed in "an integrated production process." There is no parallel provision for the exemption provided at IC § 6-2.5-5-40. Utilities consumed in R&D activities are entitled a straight-forward, dollar-for-dollar sales tax exemption. In addition, the Department points out that there is no provision allowing taxpayers, conducting both production and R&D activities, to "stack" the two exemptions in order to meet the predominant use standard. In other words, taxpayers consuming 30 percent of utilities in production and 25 percent in R&D activities are entitled to a 55 percent exemption and not a 100 percent predominantly used exemption.

The Department disagrees with Taxpayer's claim that it is presumptively entitled to a R&D predominant use provision for utilities consumed in R&D activities or that the Department's original conclusions on this particular issue were incorrect.

## **(2) Analysis of Taxpayer's "Sales and Use Tax Compliance Agreement" ("SUTCA") Issue.**

In one instance, the Department had previously entered into a SUTCA with one of Taxpayer's entities. A "SUTCA" is:

[A]n agreement between a taxing agency and a taxpayer providing simplified procedures under which the taxpayer is to calculate and remit unpaid sales or use tax on its purchases . . . . SUTCAs involve an "up-front" agreement specifying the manner in which tax is to be computed and remitted at the time of a purchase, the accuracy of which will be evaluated at a later point." Federation of Tax Administrators, <https://www.taxadmin.org/assets/docs/Publications/sutca.pdf>. (last visited March 10, 2020).

For this particular SUTCA, the agreement addressed "the taxation of the use of its equipment and other purchases for its research and development (R&D)." The SUTCA called for this entity "to remit use tax to the Department on 2.8644[percent] of purchases for the account listed in the SUTCA agreement."

In this particular instance, Taxpayer submitted the GA-110L refund request in order to receive a refund of tax in apparent excess of the amount called for in the agreement. In reviewing that refund claim, the Department objected for two reasons: The GA-110L requested a refund of sales tax paid on utilities but "[u]tilities were not part of the SUTCA agreement." In addition, the GA-110L "included purchases that were \$10,000.00 or more in its SUTCA calculation." The SUTCA called for "large dollar" purchases to be reviewed "outside the scope of the SUTCA." Accordingly, the Department's audit removed from initial consideration issues related to the utility exemption and purchases in excess of \$10,000. However, after a separate review of the "large dollar" and utility transactions, the Department denied approximately \$150,000 of the \$200,000 amount originally requested.

In this one instance, Taxpayer has provided nothing which would in any way lead the Department to question or set aside the audit's analysis and findings.

## **FINDING**

Taxpayer's protest is respectfully denied. Taxpayer's interpretation and reliance on the "predominant use" standard is unfounded; Taxpayer has presented nothing which would lead the Department to question the audit's interpretation and application of the SUTCA.

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